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KAY JEWELRY STORES, INC.

Annual Report

FOR THE FISCAL YEAR ENDED JUNE 30, 1962

Dear Stockholder:

Certified audited figures for your Company for the fiscal year ended June 30, 1962 show that the Company earned $131,462 before provision for federal income taxes of $157,400. (See Note "C" to financial statements). Therefore, the operation shows a net loss of $25,938 this year as against a net loss of $588,639 for the year ended June 30, 1961.

Consolidated net sales for the period ended June 30, 1962 were $27,661,269 against $23,384,717 the previous year.

In the past 18 months we have closed 28 stores which had been accruing losses for some time. The fact is that their pre-tax loss was approximately $530,000. Eliminating these units places the Company in a much better position to earn, and will result in loosening some $2,000,000 of invested capital.

Our 46 discount jewelry departments, as well as our Fairfax Products Division, have not yet hit their stride. It is felt that they will produce a profit during the present fiscal year, which of course will contribute to the consolidated net profit of the Company.

Your officers and members of the Board of Directors are naturally anxious to improve the earning position of the Company. We believe we have accomplished much by the elimination of loss stores and are currently improving the volume of business. We feel that with the steps taken a vastly improved situation will result by the end of the next fiscal period.

You have previously been notified that the Annual Meeting of Stockholders will be held on September 26, 1962, at 11:00 a.m., E.D.S.T. at the offices of the Company, 1328 New York Avenue, N.W., Washington, D. C.

Respectfully,

C. D. Kaufmann, *President*

September, 1962

KAY JEWELRY STORES, INC.

CONSOLIDATED BALANCE

Assets

CURRENT ASSETS:		
Cash		$ 2,386,158
Marketable securities		13,442
Accounts and notes receivable:		
Trade instalment balances (a portion of which is due after one year) (Note A)	$10,166,741	
Other trade accounts and notes	1,093,639	
	$11,260,380	
Less allowances for doubtful balances and unearned service fees	694,400	10,565,980
Merchandise inventories, at the lower of cost or market, as determined principally by the retail inventory method		9,984,774
Prepaid expenses		351,134
TOTAL CURRENT ASSETS		$23,301,488
OTHER ASSETS:		
Investments in, and advances to, associated companies (Note B)	$ 350,722	
Cash surrender value of insurance on lives of officers	217,259	
Unamortized discount on 5½% note	94,433	
Miscellaneous	277,708	940,122
PROPERTY AND EQUIPMENT—at cost:		
Land	$ 100,000	
Building and building improvements	675,204	
Leasehold and leasehold improvements	1,492,237	
Furniture and fixtures	1,863,448	
Automobiles	4,824	
	$ 4,135,713	
Less accumulated depreciation	1,426,162	2,709,551
		$26,951,161

AND SUBSIDIARY COMPANIES

SHEET, JUNE 30, 1962

Liabilities and Stockholders' Investment

CURRENT LIABILITIES:		
Notes and loans payable:		
Banks		$ 455,000
Commercial finance company (Note A)		2,749,641
Current portion of long-term debt		363,400
Others		734,694
Trade accounts payable		3,563,861
Accrued salaries and interest		164,773
Federal income taxes (Note C)		299,797
Federal excise and other taxes		722,063
TOTAL CURRENT LIABILITIES		$ 9,053,229
DEFERRED FEDERAL INCOME TAXES ON GROSS MARGIN (Note C)		1,243,590
LONG-TERM DEBT:		
5½% note payable due in equal annual instalments of $350,000, less current portion (Note D)	$ 3,950,000	
Mortgage payable on land, building and building improvements, interest at 4½%—payable in quarterly instalments of $8,125 on account of principal and interest until maturity in 1976, less current portion	416,798	4,366,798
MINORITY INTERESTS IN SUBSIDIARY COMPANIES:		
Preferred stock	$ 25,969	
Common stock and surplus	1,084,368	1,110,337
STOCKHOLDERS' INVESTMENT:		
Capital stock, par value $1 per share (Note E): Authorized, 1,000,000 shares Issued, 599,260 shares	$ 599,260	
Additional paid-in capital (no change during year)	10,095,214	
Retained earnings (Note D)	572,451	
Cost of 8,000 shares of capital stock held in treasury (deduction*)	89,718*	11,177,207
		$26,951,161

See notes to financial statements.

KAY JEWELRY STORES, INC.
AND SUBSIDIARY COMPANIES

CONSOLIDATED LOSS
YEAR ENDED JUNE 30, 1962

INCOME:		
Net sales (including $2,183,574 to associated companies)		$27,661,269
Service fees, dividends, interest and other income		2,248,688
		$29,909,957
COSTS AND EXPENSES:		
Cost of sales (including buying and occupancy expenses)	$19,215,679	
Administrative, publicity and selling expenses	9,834,905	
Interest expense	718,233	
Earnings applicable to minority interests in subsidiary companies	2,597	
Other	7,081	29,778,495
		$ 131,462
Federal income taxes (Note C)		157,400
NET LOSS		$ 25,938*

See notes to financial statements.

* Red figure.

CONSOLIDATED RETAINED EARNINGS

YEAR ENDED JUNE 30, 1962

Balance, July 1, 1961	$ 598,389
Net Loss	25,938*
Balance, June 30, 1962	$ 572,451

See notes to financial statements

* Red figure.

KAY JEWELRY STORES, INC.
AND SUBSIDIARY COMPANIES
NOTES TO FINANCIAL STATEMENTS

The accompanying consolidated financial statements include the financial statements of Kay Jewelry Stores, Inc. and its majority-owned subsidiary companies.

A. *Loans payable to commercial finance company:*

Certain store subsidiary corporations have assigned customers' instalment accounts as collateral on loans payable to a commercial finance company. The aggregate amount of such accounts assigned at June 30, 1962 was $3,437,000. The loan balances are liquidated by 80% of the cash collected on assigned accounts.

B. *Investments in, and advances to, associated companies:*

The items included under this caption consist of loans ($88,660) and investments ($262,062) in the capital stock of 11 associated store corporations. The equity in the net assets of these store corporations amounted to approximately $321,000 at June 30, 1962.

C. *Federal income taxes:*

The provision for federal income taxes is greater than the consolidated earnings before federal income taxes because of unrecorded tax credits. Federal income taxes are computed on an individual basis for each company included in the consolidated financial statements. When a company incurs a loss, a tax credit is recorded as a claim for refund of taxes paid in prior years or as an adjustment of deferred income taxes accrued in prior years. To the extent that such credits are not available, no tax effect of the loss is recorded in the current year. At June 30, 1962 companies included in the consolidation had accumulated losses aggregating $1,145,000 which are available to reduce future years' taxable income.

Gross margin on instalment sales is taken into income at the time the sales are made, that is, on the accrual basis. Provision for federal income taxes is made on such gross margin, including that portion deferred for federal income tax purposes.

On September 17, 1962 the Board of Directors of the Company adopted a plan of liquidation of one of its wholly-owned subsidiary companies. Such liquidation will, in the opinion of legal counsel, make the tax losses of the subsidiary company available to the parent company in the future. The effect of the liquidation was considered in the computation of the deferred federal income taxes as of June 30, 1962, reducing the total federal income taxes by $240,400.

D. *5½% note payable:*

The loan agreement relating to the 5½% note payable contains certain restrictions relative to, among other things, the payment of cash dividends, purchase of the Company's capital stock and maintenance of consolidated current assets. As of June 30, 1962 the Company may not pay cash dividends on its capital stock.

E. *Stock options and warrants:*

On July 13, 1962 the Board of Directors approved a plan whereby five-year options to purchase 25,000 shares of the Company's common stock were granted to the president of the Company. The option price is $9.90 a share, 110% of the market price at the date of grant, July 13, 1962. Options to purchase 12,500 shares become exercisable on July 13, 1963 and the remainder become exercisable one year thereafter. If this plan is ratified by the stockholders, the previous option agreement with the president of the Company granting 25,000 shares at an option price of $19.80 a share, 110% of the market price at the date of grant, January 1, 1959, with 5,000 shares becoming exercisable on January 9, 1960, and the remainder one year thereafter will be terminated and all options under such plan will be cancelled.

In connection with the arrangement for the 5½% note payable, five-year warrants to purchase 25,000 shares of the Company's capital stock were granted on January 31, 1959 to a non-affiliated corporation. The warrants were to be exercised in whole but

not in part at a price of $19.00 per share. Due to the subsequent issue of stock dividends, the warrants currently may be exercised for 26,010 shares at a price of $18.26 per share.

On October 15, 1959, the Company adopted a restricted stock option plan for the benefit of employees. Under the employees restricted stock option plan, adopted in 1959, 35,000 shares have been reserved for issuance at a price which will be not less than 95% of the market value at the date of grant. At June 30, 1962 no stock options had been granted.

F. *Long-term leases:*

At June 30, 1962, companies included in the accompanying consolidated financial statements were lessees under 78 leases having terms of more than three years from that date with minimum annual rentals of $910,000 plus, in some cases, real estate taxes and, in certain instances, increased amounts based on percentages of sales. No individual lease is deemed significant in relation to the enterprise as a whole, the highest minimum annual rental being $36,000. 62 of such leases expire prior to June 30, 1972.

G. *Contingencies:*

District of Columbia income tax returns of the parent company for the years 1958, 1959 and 1960 have been examined and deficiencies aggregating $159,000 have been proposed. The Company intends to contest the proposed deficiencies to the fullest extent possible. Inasmuch as it is impossible to predict the ultimate result of the proposal, no provision has been made in the financial statements for taxes and interest which would become payable if the proposal of the taxing authority is sustained. In the opinion of the Company and legal counsel the proposal is without substantial merit and legal counsel and the Company believe the final disposition should not have a material effect on the financial statements.

Federal income tax returns of the Company for 1960 and 1961 are presently being examined by the Internal Revenue Service. Preliminary discussions regarding this examination have revealed that tax adjustments may be proposed which would substantially exceed amounts provided therefor. The Company does not know the amount of the tax adjustment which will be proposed, but the Company and legal counsel believe that no significant liability will result therefrom.

STOCKHOLDERS AND BOARD
OF DIRECTORS

KAY JEWELRY STORES, INC.
Washington, D. C.

September 18, 1962

We have examined the consolidated balance sheet of Kay Jewelry Stores, Inc. and subsidiary companies as of June 30, 1962 and the related consolidated statements of loss and retained earnings for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying financial statements present fairly the consolidated financial position of Kay Jewelry Stores, Inc. and subsidiary companies at June 30, 1962, and the consolidated results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Touche, Ross, Bailey & Smart

Certified Public Accountants

KAY JEWELRY STORES, INC.

1328 New York Avenue, N.W. • Washington 5, D. C.

DIRECTORS

MARK A. FREEDMAN
BENJAMIN B. GOLDING
SIMON HIRSHMAN
HOMER A. JONAS
CECIL D. KAUFMANN
DONALD J. KAUFMANN
JOEL S. KAUFMANN

BARTLETT PINKHAM
(Associate: Allen & Co., New York, N.Y.)

HARRY J. RUDICK
(Partner: Lord, Day & Lord, Attorneys-At-Law, New York, N.Y.)

HAROLD D. TRATTNER

OFFICERS

CECIL D. KAUFMANN, *President*
BENJAMIN B. GOLDING, *Vice President*
JOEL S. KAUFMANN, *Treasurer*
SIMON HIRSHMAN, *Secretary*

Auditors: TOUCHE, ROSS, BAILEY & SMART, Washington, D. C.